

Internal Revenue Service
memorandum

CC:TL-N-469-92
FS:IT&A:MLOsborne

date: NOV 7 1991

to: District Counsel, St. Paul CC:MW:SP

from: Assistant Chief Counsel (Field Service) CC:FS

subject: [REDACTED]

This is in response to your request dated October 9, 1991, for Field Service Advice in the above-referenced case concerning respondent's disallowance of petitioner's reserve for estimated shrinkage.

ISSUES

1) Whether, as a matter of law, I.R.C. § 471 and the regulations thereunder permit estimates of inventory shrinkage. If so, whether the shrinkage amount taken by the petitioner was reasonable.

2) Whether a motion for summary judgment is appropriate in this case.

CONCLUSIONS

1) Service position is that no reserves for inventory shrinkage are allowed as a matter of law under section 471 and the regulations thereunder.

2) Because there is no genuine dispute as to the material facts, a motion for summary judgment appears appropriate in this case.

DISCUSSION

As you are aware, [REDACTED] was designated for litigation on [REDACTED] for the taxable years [REDACTED] and [REDACTED] on the specific issue of inventory shrinkage. In this case, the designation for litigation was based upon a Coordinated Issue Paper, which was agreed to by all functions of the Service (Appeals, Counsel, and Exam). Thus, it was inherent in the process of designation of this particular case that both functions of Counsel, Technical and Litigation, agreed with the underlying position.

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This conclusion that a taxpayer may not reduce ending book inventory based on an estimate of shrinkage is Service position. Such position was established by all functions of the Service, as reflected both in the Retail Industry's Coordinated Issue Paper on Inventory Shrinkage Reserves and in a proposed revenue ruling. Although the proposed revenue ruling has never been "officially cleared," the position taken was approved by Acting Chief Counsel Peter Scott and Mark Levy of Tax Legislative Counsel. The Acting Chief Counsel suggested, however, that some form of administrative relief be granted. Publication of the ruling has only been delayed to permit development of the companion revenue procedure granting some form of administrative relief. Accordingly, the position in the statutory notice of deficiency corresponds completely with Service position.

Because there is no genuine dispute as to the material facts, we agree that a motion for summary judgment may be appropriate in this case. Thus, the Tax Court can rule on the legal issue of whether section 471 and the regulations thereunder permit an inventory reduction for estimated shrinkage.

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